Supreme Court, U.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-1459

CHARLES G. RODMAN, as Trustee of the Estate of W. T. Grant Company, Bankrupt,

Petitioner,

v.

ALTON RINIER, as Agent for Certain Employees of Bankrupt, ANSWERING EMPLOYEES OF BANKRUPT, LOCAL 807-IBT, RETAIL CLERKS INTERNATIONAL ASSOCIATION, NATIONAL LABOR RELATIONS BOARD,

Respondents.

PETITIONER'S REPLY BRIEF

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Respondents.

PETITIONER'S REPLY BRIEF

Petitioner, Charles G. Rodman, as Trustee of the Estate of W. T. Grant Company, Bankrupt (the "Trustee"), replies to the opposing briefs filed by respondents Answering Employees of Bankrupt, the Retail Clerks International Association and the National Labor Relations Board (the "Answering Employees", the "RCIA" and the "NLRB", respectfully, collectively the "Respondents"). As of the date hereof, no briefs in opposition to the Trustee's petition have been served upon the Trustee by Local 807-IBT or Alton Rinier, as agent for certain employees of bankrupt.

I

THE CONFLICT AMONG THE COURTS OF APPEAL IS INCONTROVERTIBLE

A. Conflict as to Treatment to be Afforded to Severance Pay Benefit Claims

In substantial part, the Answering Employees' and the RCIA's opposition to the issuance of a writ of certiorari is predicated upon their misconception that the decisions of the United States Court of Appeals for the First Circuit in *In re Mammoth Mart, Inc.*, 536 F.2d 950 (1st Cir. 1976), the United States Court of Appeals for the Third Circuit in *In re Public Ledger, Inc.*, 161 F.2d 762 (3rd Cir. 1947), and of the court in *In re Diamond REO Trucks, Inc.*, 20 Collier Bankr. Cases 1130 (W.D. Mich. 1979), which is based upon *Mammoth Mart* and *Public Ledger*, are not inconsistent with the decision of the Second Circuit that severance pay benefits earned on the basis of years of service are not allocable in the same manner as wages under the Bankruptcy Act (the "Act"). The Second Circuit, however, clearly recognized the existence of the conflict:

> Finally, in the alternative, appellants urge that, if *Straus-Duparquet* is fatal to their claim, we should overrule that decision since other courts have declined to follow it. *In re Mammoth Mart, Inc.*, 536 F.2d 950 (1 Cir. 1976); *In re Diamond Reo Trucks, Inc.*, No. 74-1788 B 5 (W.D. Mich. June 19, 1979). Our Court, however, repeatedly has followed *Straus Duparquet. See, e.g., In re Unishops, Inc., supra; In re Bohack Corp.*, 535 F.2d 1240 (2 Cir. 1975), (memorandum order), *cert. denied*, 425 U.S. 966 (1976). In our opinion the rationale of *Straus-Duparquet*—that severance pay is compensation—is sound. We decline appellants' invitation to overrule *Straus-Duparquet*, which remains the law of this circuit.

Joint Appendix I at 6a-7a.

In contrast to the Answering Employees and RCIA, the NLRB acknowledges that a fundamental conflict exists. (Brief of NLRB at 5-7). It attempts to avoid the consequences of the conflict by contending that the conflict has been rendered moot by the passage of the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978)

(the "Code"). Specifically, the NLRB refers to Section 507(a)(3) of the Code, 11 U.S.C. § 507(a)(3), which accords priority to severance pay benefits *earned* before the filing of a petition. Reliance upon that section is misplaced. As the NLRB itself concedes, the Code leaves unresolved how severance pay benefits should be treated when an employee is terminated *during* the course of a case under the Code. (Brief of NLRB at 7). Thus, the need for this Court to address the issue, and to resolve the conflict, is left unaffected by the passage of the Code.

B. Conflict as to Assumption of Executory Contracts Without Court Approval

As demonstrated in the Trustee's petition, the Second Circuit, in determining that a debtor-in-possession may assume by inaction a bankrupt's executory policies and agreements, rejected the principle articulated by other courts of appeal that assumption requires an *express* order of the court. The rationale of the decisions in conflict with the Second Circuit's ruling is predicated upon the fact that assumption of executory contracts may result in the elevation of general unsecured claims to first priority status as costs and expenses of administration under Section 64a(1) of the Act, 11 U.S.C. § 104a(1). Consequently, assumption should not occur absent court scrutiny. *Local Joint Executive Board, AFL-CIO* v. *Hotel Circle, Inc.*, 613 F.2d 210 (9th Cir. 1980); *In re Gulfco Investment Corp.*, 520 F.2d 741 (10th Cir. 1975); *In re Maryvale Community Hospital, Inc.*, 456 F.2d 414 (9th Cir.), *cert. denied*, 409 U.S. 879 (1972); *In re American National Trust*, 426 F.2d 1059 (7th Cir. 1970); *Texas Importing Co.* v. *Banco Popular de Puerto Rico*, 360 F.2d 582 (5th Cir. 1966); *see also* 6 Collier, *Bankruptcy* ¶ 3.23 [5] at 578 (14th ed. 1976).

Cognizant that the holdings of the above-cited cases are directly contrary to the Second Circuit's decision, the Answering Employees refuse to accept the existence of this fundamental conflict by distinguishing on inconsequential grounds the Second Circuit's decision from the decisions of the Fifth, Seventh, Ninth and Tenth Circuits. Thus, it is

urged that certain of the Circuit Courts' decisions are distinguishable since they relate to Chapter X cases while the W. T. Grant Company ("Grant") case was initially a case under Chapter XI under the Act. The distinction is a difference without meaning. Whether a case is commenced under Chapter X or Chapter XI of the Act, the effect of a debtor-in-possession's or a trustee's assumption of pre-bankruptcy obligations is the same—the elevation of potentially substantial pre-petition, non-priority claims to priority administrative claims. As a consequence, not only may the debtor be unable to effect a reorganization, but pre-bankruptcy general unsecured creditors may be prejudiced on account of the satisfaction in full of such administrative claims. Thus, the necessity for the court to scrutinize the assumption of an executory agreement is the same regardless of whether the assumption occurs in a Chapter X or a Chapter XI case.

The Answering Employees also seek to distinguish the decisions of the Fifth, Seventh, Ninth and Tenth Circuits on the grounds that the issue in those decisions was "whether the debtor-in-possession could be bound in the future to a contract without court approval." The Answering Employees erroneously contend that the Grant agreements were not similarly long-term in nature. But the right of former Grant employees to receive severance pay benefits is set forth in only a part of a voluminous set of policies and collective bargaining agreements governing all aspects of the Grant employee-employer relationship. It is evident that the assumption of all such executory policies and agreements, had it occurred, would have affected future long-term obligations of Grant. It is incontrovertible, therefore, that while the Second Circuit was dealing with the *same issue* as that presented to the other Circuit Courts, the rule enunciated by the Second Circuit is contrary to the principle established by those courts.

The Answering Employees also misconstrue the decisions of the other circuits when they assert that the other courts of appeal did not consider whether acceptance of benefits by the debtors-in-possession or the trustees under pre-bankruptcy executory agreements gave rise to an assumption of such

agreements. That was not the case. In *Hotel Circle, supra*, for example, the Ninth Circuit considered all of the benefits received under the executory agreement during the course of the Chapter XI case. The court noted that a receiver had operated the debtor's business in accordance with provisions of a pre-bankruptcy executory collective bargaining agreement, had continued in his employ those employees of the debtor who were covered by such agreement, and had participated in the negotiations relating thereto. Nevertheless, the court held that, in the absence of assumption *with court approval*, neither the receiver nor the estate was bound by the executory provisions of the agreement.

Further, by asserting that the former employees would be deprived of compensation for the services that they rendered to the debtor-in-possession while in its employ if their entire severance pay claims were not afforded priority status, the Answering Employees would have this Court believe that none of the former employees received any compensation during Grant's Chapter XI case. In fact, throughout the course of Grant's aborted Chapter XI case, employees received wages on a current basis from the debtor-in-possession.

C. Conflict as to Whether Severance Pay Benefits Constitute a Component of Wages

Grant's pre-Chapter XI policies and agreements provided that the amount of severance pay benefits was dependent upon the employee's length of employment. Thus, the dollar amount of severance pay benefits was a direct function of the employee's period of service. As an employee's tenure with Grant increased, so did the amount of his or her entitlement to severance pay. Despite that fact, the Second Circuit rejected the concept that severance pay benefits were earned on a day-to-day basis like wages.

In its brief in opposition to Trustee's petition, the RCIA relies upon *McCloskey* v. *Division of Labor Law Enforcement*, 200 F.2d 402 (9th Cir. 1952), and *In re Elliot Wholesale Grocery Co.*, 98 F. Supp. 1017 (S.D.Cal. 1951), as supporting the conclusion of the Second Circuit that severance pay is not a component of wages. In those cases the employees were

discharged prior to the commencement of the bankruptcy cases. The severance pay provisions in the collective bargaining agreements provided that the employees were entitled to one week's notice prior to severance, or in lieu thereof, one week's pay. Because the severance pay entitlement *was not predicated on length of employment*, the courts dismissed the argument that severance pay was earned at the time the employees were first employed by the bankrupt. Rather, the courts found that the severance pay benefits were earned at the time the employees were discharged and thereby accorded the severance pay claims the wage priority provided under Section 64a(2) of the Act, 11 U.S.C. § 104a(2).

In contrast, the Grant severance pay provisions do not provide for severance pay in lieu of notice. The Grant entitlement to severance pay is predicated upon tenure of employment. Such benefits are earned throughout the employment period and not at the time of discharge. Therefore, while the facts of *McCloskey* and *Elliot Wholesale Grocery* are distinguishable from those of the Grant case, the rationale of their holdings, i.e., that severance pay benefits are wages, is apposite. Thus, *McCloskey* demonstrates a further conflict between the Ninth Circuit and the Second Circuit as to the proper characterization of severance pay benefits as wages.

In re Ad Service Engraving Co., 338 F.2d 41 (6th Cir. 1964), cited by the RCIA in support of the proposition adopted by the Second Circuit that severance pay represents damages for severance rather than wages, while inapposite, is nevertheless instructive. In *Ad Service*, the severance pay provision was similar to the provisions in *McCloskey* and *Elliot Wholesale Grocery*, i.e., severance pay in lieu of notice of termination. In characterizing severance pay as damages and not as wages entitled to the wage priority under Section 64a(2) of the Act, *supra*, the court distinguished its holding from that of *Public Ledger*, *supra*, on the grounds that, unlike the collective bargaining agreement in *Ad Service*, the pertinent collective bargaining agreement in *Public Ledger* "provided for severance pay regardless of notice if the employee had earned it by working for a specified period." 338 F.2d at

44. As discussed above, the severance pay provisions contained in Grant's pre-bankruptcy policies and agreements, like the collective bargaining agreement in *Public Ledger*, provided that the amount of an employee's severance pay and benefit entitlement was predicated upon his or her length of employment with Grant. Thus, *Ad Service* is in accord with the principle rejected by the Second Circuit that severance pay benefits payable to former employees of Grant are properly characterized as wages earned in the course of employment. Rather than supporting th Second Circuit's decision, *Ad Service* reflects a conflict between the Sixth and Second Circuits.

In view of the Second Circuit's decision, the rule as to (a) whether priority under the Act should be accorded to severance pay claims of employees who are terminated during the course of a case under the Act, (b) whether pre-bankruptcy contracts may be assumed by a debtor-in-possession without court approval and (c) whether severance pay benefits are a component of wages, will depend upon the judicial district in which the debtor's case under the Act is pending. Such a disparity is contrary to and undermines the concept of a uniform federal bankruptcy system. Accordingly, clarification of the issues by the Supreme Court is essential. Thus, a writ of certiorari should issue.

II

THE GOVERNING AGREEMENTS IN RESPECT OF SEVERANCE PAY BENEFITS ARE EXECUTORY CONTRACTS

Cognizant of the importance of this Court's resolution of the issue as to whether or not a debtor-in-possession in a reorganization case may assume pre-petition executory policies and agreements without the knowledge and consent of the bankruptcy court, the Answering Employees and the RCIA adopt the position that Grant's policies and collective bargaining agreements were not executory. Thus, they contend that issue of whether or not the contracts were assumed by the debtor-in-possession by inaction is irrelevant.

The Answering Employees and the RCIA assert that at the time employees were terminated, Grant's only obligation was to pay severance pay benefits. That obligation, they contend, is not executory. While the proposition that the mere payment of money does not constitute an executory agreement may be correct, it is inapplicable to the uncontroverted facts of this case.

As stated above, the right of former employees to severance pay benefits is not set forth in a singular agreement. It is set forth in voluminous documents containing labor policies and in lengthy collective bargaining agreements that deal with *all* aspects of the employer-employee relationship. Each provision in an executory agreement should not be considered a separate agreement. Rather, executory agreements must be examined in their entirety. *In re Klaber Bros.*, 173 F. Supp. 83 (S.D.N.Y. 1959); 8 Collier, *Bankruptcy* ¶ 3.15 [7] at 205 (14th ed. 1978). In that context, Grant's policies and collective bargaining agreements were clearly executory. Further, as is implicit in the decisions cited by the Answering Employees, whether a pre-Chapter XI contract is executory is based upon the status of the contract at the time the Chapter XI petition is filed. *In re Computer Utilization, Inc.*, 508 F.2d 673 (5th Cir. 1975); *Crittenden* v. *Lines*, 327 F.2d 537 (9th Cir. 1964); *In re San Francisco Bay Exposition*, 50 F. Supp. 344 (N.D. Cal. 1943). Patently, Grant's pre-Chapter XI policies and collective bargaining agreements were, in their entirety, executory as of the date of the filing of the Chapter XI petition.

Moreover, the Answering Employees and the RCIA do not fully address the fact that, as of the date that Grant filed its Chapter XI, the severance pay constituted contingent claims, provable under Section 63a(8) of the Act, 11 U.S.C. § 103a(8). Whether the claims were allowable as of that date was dependent upon the occurrence of a post-petition event, i.e., the termination of employment. The mere fact that these pre-petition claims did not mature or become payable until after the commencement of the case does not transform them from pre-petition claims to administrative expenses. To so hold would result in making every claim that is

contingent or may be based upon an anticipatory breach of a contract a cost and expense of administration, a result contrary to Sections 63a(8) and (9) of the Act, 11 U.S.C. §§ 103a(8) and (9), which provide for the provability of such claims as pre-petition general unsecured claims. *Nathanson* v. *NLRB*, 344 U.S. 25 (1959); *In re Godwin Bevers Co., Inc.*, 575 F.2d 805 (10th Cir. 1978); *Denton & Anderson Co.* v. *Induction Heating Corp.*, 178 F.2d 841 (2d Cir. 1949).

In furtherance of its contention that the Second Circuit properly concluded that severance pay benefit claims are entitled to satisfaction in full as administration claims under Section 64a(1) of the Act, *supra*, the RCIA notes the Trustee's acknowledgement that the calculation of a former employee's entitlement to severance pay benefits is governed by the provisions of the collective bargaining agreements. The RCIA contends, therefore, that the Trustee can only calculate such entitlement in that manner if the collective bargaining agreements are binding upon the Trustee. If they are binding, the RCIA concludes, the severance pay benefit claims must be administrative expenses of the Chapter XI case.

The argument is without foundation. The claims resulting from the breach or rejection of any pre- or post-Chapter XI executory contract are always governed by the provisions of the contract, subject to the Act. That fact does not give rise to a priority or administrative claim. If that were the case, an executory labor agreement breached immediately prior to or rejected immediately subsequent to the filing of a Chapter XI case would give rise to a priority or administrative claim, clearly an illogical result without any basis in the Act or in decisional law.

Rather than demonstrating grounds for the denial of the Trustee's petition, the Respondents have highlighted the significant disparities between the approach taken by the Second Circuit and that of other Circuit Courts as to fundamental issues which must be considered in almost every reorganization case under the federal bankruptcy law. This Court's clarification of these issues as to the treatment of

claims of employees and the assumption of executory contracts will insure that the federal bankruptcy law is uniform. The necessity for the Court's clarification is not obviated by the enactment of the Code. The failure to grant the Trustee's petition will allow the present uncertainty and inconsistent results relative to the treatment of executory policies and contracts to persist, thereby not only placing the ability of businesses to reorganize at substantial risk, but also encouraging further litigation until such time as a uniform approach is eventually adopted.

CONCLUSION

A writ of certiorari should issue to review the judgment and decree of the Second Circuit.

Dated: New York, New York
May 22, 1980

Respectfully,

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